

## NOTES

### THE ASSIGNMENT OF GOVERNMENT CONTRACTS AS COLLATERAL

Outstanding among recent legislation designed to improve the position of small business in a defense economy<sup>1</sup> is the Assignment of Claims Act of 1940.<sup>2</sup> The greater risk involved in loans to smaller concerns places them at a competitive disadvantage in satisfying their credit needs.<sup>3</sup> Adjustment to shortages of essential materials, the unavoidable inequities of price restrictions, and the increasing predominance of the Government in the national markets requires a flexibility that many a business organization can only achieve through increased working capital. The Assignment of Claims Act was designed to further the participation of small business in defense contracting by facilitating the financing of such contracts through the assignment of the executory contract as collateral for loans.<sup>4</sup> This note is an inquiry into the legal problems raised by that Act and its subsequent amendments, and to a lesser degree into the practicality of such an assignment as a security device. Entirely aside from the conjectural long range effects of this legislation, the very fact that some sixty billions will be spent this year on national defense<sup>5</sup> renders the capacity of the Act to improve the credit position of small business a matter of considerable present interest to entrepreneur and financier alike.

#### HISTORICAL BACKGROUND

A review of the legislation antedating the 1940 Assignment of Claims Act not only affords a desirable perspective, but is otherwise essential to this study because the prior law remains in force with respect to all assignments not within the narrow terms of the 1940 Act. Federal statutes restricting the assignment of claims against the Government date back to 1792.<sup>6</sup> The statute in force prior to the Assignment of Claims Act of 1940 declared in unequivocal terms that:

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1. See Shestack and Long, *The Small Businessman and Government Contracts*, 11 LA. L. REV. 426 (1951); Frey, *Maintaining Economic Freedom Under the Defense Act of 1940*, 18 U. OF CHI. L. REV. 218 (1950); see also *Senate Concurrent Resolution No. 14*, 80th Cong., 1st Sess., 93 CONG. REC. 4756, 9582 (1947).

2. 54 STAT. 1029 (1940), 31 U.S.C. § 203, 41 U.S.C. § 15 (1950).

3. See, e.g., Wilhelm, *How Small Business Competes for Funds*, 11 LAW & CONTEMP. PROB. 220 (1945).

4. The concept of the assignment of a contract is a multiple one, see 4 CORBIN, CONTRACTS § 863 (1951). It will herein be used solely in reference to the assignment of a right to the payment of money due upon an executed contract or conditionally due upon the performance of an executory contract and not to the assignment of contractual duties which is prohibited by 54 STAT. 1029 (1940); 41 U.S.C. § 15 (1946).

5. N.Y. Times, Jan. 22, 1952, p. 20, Col. 2.

"All transfers and assignments made of any claim upon the United States, or of any part or share thereof . . . and all powers of attorney for receiving payment . . . shall be absolutely null and void, unless . . . executed in the presence of at least two attesting witnesses, after the allowance of such a claim, the ascertainment of the amount due and the issuing of a warrant for the payment thereof." <sup>7</sup>

This stern prohibition was calculated to protect the Government from frauds upon the Treasury, to relieve it of the expenses incident to the investigation of multiple claims, and to prevent the abuses that might arise if persons of influence purchased claims and improperly urged them upon the Government. So at least the statute was interpreted,<sup>8</sup> and strictly applied, with the result that all voluntary assignments not conforming to the statutory requirements were held unenforceable against the United States.<sup>9</sup> The courts, however, permitted the Government, the intended beneficiary of the statute, to waive the protection granted therein, and by paying the allowed claim to the assignee, discharge its obligation to the assignor.<sup>10</sup> These waiver decisions inferentially recognized that an assignment in opposition to the statute nevertheless transferred some interest in the claim assigned between the private parties. Unfortunately the cases faced squarely with that question, which is one that may still arise, have reached no consistent conclusion.

The frequently cited case of *National Bank of Commerce v. Downie*, in which the assignee of an unliquidated claim sued the assignor's trustee in bankruptcy, interpreted the statute literally and held that a non-conforming assignment was for all purposes null and void, passing no interest "present or remote, legal or equitable."<sup>11</sup> On the other hand, where the original claim had been allowed before suit or the money paid in court, there is authority for the proposition that effect may be given to the agreement between the private parties, since the statute does not prohibit assignment.<sup>12</sup> The Supreme Court, with *Martin v. National Surety Co.*<sup>13</sup> seemed

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6. 1 STAT. 245 § 2 (1792).

7. 9 STAT. 41 (1846); 10 STAT. 170 (1853), REV. STAT. § 3477 (1878), as amended, 35 STAT. 411 (1908); 31 U.S.C. § 203 (1940).

8. See, e.g., *United States v. Gillis*, 95 U.S. 407, 416 (1877); *Spoffard v. Kirk*, 97 U.S. 484, 490 (1878); *Price v. Forrest*, 173 U.S. 410 (1899); *Milliken v. Barrow*, 65 Fed. 888 (C.C.E.D. La. 1895).

9. See, e.g., *United States v. Gillis*, 95 U.S. 407 (1877); *Spoffard v. Kirk*, 97 U.S. 484 (1878). Interesting recent authority braking an incipient liberal tendency is *United States v. Shannon*, 342 U.S. 808 (1952), reversing 186 F.2d 430 (4th Cir. 1951).

10. See, e.g., *Goodman v. Niblack*, 102 U.S. 556 (1880); *Bailey v. United States*, 109 U.S. 432 (1883); *Price v. Forrest*, 173 U.S. 410 (1899); *Bank of California National Ass'n v. Comm'r of Internal Revenue*, 133 F.2d 428 (9th Cir. 1943).

11. 218 U.S. 345, 356 (1910) (assignment created no preference as to the proceeds of the claim assigned); see *Spoffard v. Kirk*, 97 U.S. 484 (1878); cf. *H.M.O. Lumber Co. v. United States*, 40 F.2d 544 (W.D. Mich. 1929).

12. *Lay v. Lay*, 248 U.S. 24 (1918); *McGowan v. Parish*, 237 U.S. 285 (1915); cf. *Hobbs v. McLean*, 117 U.S. 567 (1886).

to adopt the doctrine of the latter line of cases, holding that the statute was for the protection of the Government and consequently did not prevent enforcement of the equities created by an assignment after payment by the Government had been made. This decision entirely discredited the theoretical basis of *National Bank of Commerce v. Downie* but, instead of specifically overruling it, distinguished it on the grounds that in the *Downie* case the claim had not been allowed at the time of the suit. As a result, at least one lower court subsequently felt controlled by the decision in *National Bank v. Downie* in a similar fact situation.<sup>14</sup> Another court has placed the distinction between the *Downie* and *Martin* cases on the fact that the controversy in the former concerned an unliquidated claim,<sup>15</sup> and yet a third has expressed the view that the *Martin* case in effect overrules *National Bank v. Downie*.<sup>16</sup> This appears to be the preferable view. An assignment not conforming with the statute is of course invalid against the United States, but since in some instances it is given effect between the parties,<sup>17</sup> no different result should rest on the distinction, immaterial so far as the statutory purposes are concerned, that the claim was unliquidated when assigned. The Government need only pay the original holder.<sup>18</sup> That he should be bound by his assignment is not inconsistent with congressional intent to protect the Government.

In addition to the limited enforceability of assignments between the parties, the rigors of the rule against assignment have long been relaxed in a narrow class of cases where the assignment is considered involuntary or taking effect by operation of law. In part this exception rests on the ground that the evils sought to be prevented are not present where, for example, a claim is transferred by a merger of corporations<sup>19</sup> or by an assignment in bankruptcy.<sup>20</sup> Yet, the statute has not always been applied even where the transfer may multiply the number of persons with whom the United States must deal. For example, claims passing by will or intestacy are permitted because there can be no purpose in such a case to harass the Government<sup>21</sup> and because of the unavoidable hardship of the alternative.<sup>22</sup>

13. 300 U.S. 588 (1937); see also, *McKenzie v. Irving Trust Co.*, 323 U.S. 365 (1945); *California Bank v. U.S. Fidelity & Guaranty Co.*, 129 F.2d 751 (9th Cir. 1942); *National Refining Co. v. United States*, 160 F.2d 961 (9th Cir. 1947).

14. *In re Meadow Sweet Farms*, 32 F. Supp. 119 (W.D.N.Y. 1940). Since here the claim had been collected at the time of the suit, this decision can not find support in the distinction suggested in the *Martin* case.

15. *In re Cummins Const. Co.*, 81 F. Supp. 193, 199 (D. Md. 1948).

16. *In re Webber Motor Co.*, 52 F. Supp. 742 (D.N.J. 1943).

17. *McKenzie v. Irving Trust Co.*, 323 U.S. 365 (1945); *Royal Indemnity Co. v. United States*, 93 F. Supp. 891 (Ct. Cl. 1950).

18. *Cf. United States v. Crain*, 151 F.2d 606 (8th Cir. 1945); *United States v. Certain lands in the Town of Highland, N.Y.*, 49 F. Supp. 962 (S.D.N.Y. 1943); *People of New York v. Hanley Milling Co.*, 41 F. Supp. 844 (N.D. Ohio 1940).

19. *Seaboard Air Line Ry. v. United States*, 256 U.S. 655 (1921).

20. *Goodman v. Niblack*, 102 U.S. 556 (1880).

21. See *Erwin v. United States*, 97 U.S. 392 (1878).

22. See *United States v. Aetna Casualty & Surety Co.*, 338 U.S. 366 (1949), where the court, after a thorough discussion of the rationale of these exceptions, extended them further with the holding that the subrogee of a tort claim against the federal government was not bound by the anti-assignment statute,

Save in the narrow area of these exceptions, no assignment of a claim for which the warrant of payment had not issued could be enforced against the Government until the 1940 amendment to the Assignment of Claims Act. Only parties substantially complying with its terms can benefit from its permission. For the rest, the law remains unchanged.

#### THE ASSIGNMENT OF CLAIMS ACT AS AMENDED

The exigencies of World War II demanded full mobilization of the nation's productive potential. In order to encourage small business to participate more fully in this effort, the Assignment of Claims Act was amended in 1940 to permit the assignment of Government contracts to financial institutions as collateral for loans. The long standing policy against assignment was not totally abandoned, but an exception was created. Amounts due or to become due on Government contracts could be assigned to a financing institution provided that the contract did not forbid assignment, that the assignment be for all amounts and to only one party, and that the assignee notify the contracting Government officers, the disbursing officers and the surety, if any, on the contract.<sup>23</sup>

The Amendment further provided that any War or Navy Department contract might include a no set-off clause, in which event payments to the assignee arising from the contract would not be subject to reduction for any indebtedness of the assignor to the United States arising independently of the contract assigned.<sup>24</sup> As a matter of contract law the obligor of an assigned contract may set-off against the assignee's claim any obligation of the assignor occurring prior to his receipt of notice of the assignment, but liabilities of the assignor to the obligor arising subsequent to receipt of notice may be set-off only if part of the same transaction.<sup>25</sup> The "no

23. "The provisions of the preceding paragraph shall not apply in any case in which the moneys due or to become due from the United States . . . under a contract providing for payments aggregating \$1000 or more, are assigned to a bank, trust company, or other financing institution, . . . : Provided, 1 . . . 2 . . . no claim shall be assigned if it arises under a contract which forbids such assignment; 3. That unless otherwise expressly permitted by such contract any such assignment shall cover all amounts payable . . . , shall not be made to more than one party [unless acting as agent for several participants], and shall not be subject to further assignment . . . ; 4. . . the assignee thereof shall file written notice . . . with (a) the contracting officer or the head of his department or agency; (b) the surety or sureties upon the bond or bonds, if any, . . . and (c) the disbursing officer. . . .

"Notwithstanding any law to the contrary [such an] assignment . . . shall constitute a valid assignment for all purposes." 54 STAT. 1029 (1940), as amended, 41 U.S.C. § 15 (1950).

24. The act passed with a minimum of discussion. In the process the smallest assignable contract was reduced in size from \$3000 to \$1000, and the provision for a no set-off clause added. 86 CONG. REC. 12555-60, 12803 (1940).

25. See 4 CORBIN, CONTRACTS §§ 896-7 (1951). The Comptroller General applied this rule to a contract not containing the no set-off clause in B-14876, 20 Dec. Comp. Gen. 458 (1941). The function of the Comptroller General's office is to settle claims by or against the government and on request to advise agency heads as to the propriety of payments. 42 STAT. 24 (1921), 31 U.S.C. 74 (1946). Since his function is protective, the decisions of the office tend to be conservative, leaving matters of doubt to the courts. Cf. Longwill v. United States, 17 Ct. Cl. 288 (1881).

reduction" clause permitted by the Amendment has the effect of preventing set-off of prior debts that might otherwise have been properly made before the receipt of notice. But this provision does not affect the Government's right to set-off against the contract payments its claims against the assignee.<sup>26</sup>

While no substantiating statistical totals are available, it appears that this security device was much resorted to during the war,<sup>27</sup> then declined in popularity until revived by the Korean situation and the ensuing defense program. It was then discovered that certain intervening decisions of the Comptroller General had interpreted the statute so as to maximize the risks assumed by the assignee. The first of these opinions stated that if there were a price revision under a clause in the contract, the assignee, standing in the shoes of his assignor, suffered the same reduction and could moreover be compelled to repay any excess which he might have received.<sup>28</sup> Though it was generally agreed that the expectations of the assignee were subject to diminution by the operation of such a contract clause,<sup>29</sup> the decision awakened concern as to possible further risk extensions, a concern that was vindicated by a second ruling of the Comptroller General a year later.<sup>30</sup> That case involved a contract containing the no set-off clause. It was assigned to a bank and the appropriate persons duly notified. Subsequently the contractor-assignor failed to pay either the withholding taxes or the federal unemployment taxes due on wages earned under the contract. In affirming a deduction for these unpaid taxes from the final payment to the assignee, the Comptroller General held that a set-off was proper since this liability of the assignor did not arise independently of the contract but was a necessary incident to its performance. The Court of Claims has very recently affirmed this ruling.<sup>31</sup> The implications of the Comptroller General's opinion were tremendously disquieting to the financial world, for the same logic would place on the assignee the loss from any liability of his assignor to the Government which would not have arisen but for the

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26. *Hadden v. United States*, 105 F. Supp. 1010 (Ct. Cl. 1952). Here bank was the assignee of contractor on two separate contracts. Bank became the successor in interest of contractor. The court held the government could set off against the sums owed on contract A, the amount owed by the contractor on contract B.

27. See BOLLINGER, *FINANCING DEFENSE ORDERS* (1941), for comments on its first year of operation and a number of case studies. The book seems to suggest that some of the assignment's popularity may be due to the fact that many banks during the war took credit risks they would not have considered in more normal times.

28. Comp. Gen. Dec. B-84138 (May 17, 1949).

29. See Cable, *1951 Assignment of Claims Amendment*, 68 BANKING L.J. 437 (1951). Possibly the most disturbing aspect of this decision was the suggestion that money mistakenly paid could be recovered, compare *United States v. Hadden*, note 51 *infra*.

30. Comp. Gen. Dec. B-72929, (May 18, 1950), 18 U.S.L. WEEK 2530 (1950); see excellent note, 60 YALE L.J. 549 (1951).

31. *Central Bank v. United States*, 105 F. Supp. 992 (Ct. Cl. 1952).

assigned contract. Inter alia, there might conceivably be deductions for unpaid income taxes on a cost-plus contract, renegotiation claims, or even for criminal penalties imposed on the assignor.<sup>32</sup> As to all these, the earlier decision left open the possibility that such obligations might later be recovered from an assignee who had been fully paid.

Uncertainty as to their position left to banks desiring to protect themselves the alternatives of policing their assignor, or of lending only to the most reliable contractors. Either way credit was curtailed or made more expensive. The Comptroller General in a later pacifying decision limited these prior opinions to their facts,<sup>33</sup> but the awakened fear of the Government's right of recovery against the assignee had already noticeably increased the reluctance of banks to participate in financing of this sort.<sup>34</sup>

In response to the need, Congress in May of 1951 passed a bill amending the Assignment of Claims Act of 1940. The legislative history of the 1951 Amendment indicates that its purpose was to expedite the financing of war contracts by removing the deterrent effects of the Comptroller General's opinions through a clarification and restriction of the risks assumed by the assignee.<sup>35</sup> The new Bill added a modifying paragraph to the statute in force, providing that where a contract had been assigned pursuant to the act,

“ . . . no liability of any nature of the obligor to the United States . . . whether arising from or independently of such contract, shall create or impose any liability on the part of the assignee to make restitution, refund or repayment to the United States of any amounts . . . received under the assignment.”<sup>36</sup>

The Bill also amended the no set-off provision of the 1940 Act by providing that during war or a national emergency the contracts of designated departments might include or be amended without consideration to include a term that payments to the assignee should not be subject to reduction or set-off. In such a case the Government might not reduce payments to the assignee by reason of a liability of the assignor arising independently of the

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32. See, *e.g.*, 62 STAT. 749 (1948), 18 U.S.C. § 1001 (Supp. 1950), which prescribes a fine for presenting a fraudulent claim.

33. Comp. Gen. Dec., B-99808 (Dec. 26, 1950), 19 U.S.L. WEEK 2294 (1951). This opinion stressed the fact that the decision of May 18th did not purport to consider renegotiation claims.

34. FEDERAL RESERVE BANK OF N.Y., CIRC. No. 3626 (Dec. 14, 1950): “It has come to the board's attention that a number of financing institutions have indicated their reluctance to participate in the current V-loan program . . . because of the fear that the government might recover from the assignee . . . amounts claimed by the government against the contractor. Apparently this fear has been prompted largely by certain current rulings of the Comptroller General. . . .”

35. See SEN. REP. No. 217, 82d Cong., 1st Sess., 2 U.S. CODE CONGRESSIONAL & ADMINISTRATIVE SERVICE 1414 (1951). The bill was suggested by the board of governors of the Federal Reserve System with the concurrence of the American Bankers Association.

36. 65 STAT. 42, 31 U.S.C. § 203; 65 STAT. 41, 41 U.S.C. § 15 (Supp. 1952).

contract or on account of renegotiation, whether under a term of the contract or separate statute, or on account of fines, penalties (excluding those arising from failure to comply with the terms of the contract) or from taxes, whether arising from or independently of such contract.<sup>37</sup> While it is still early to assess the effect of this Amendment, its reception in the banking community which fostered it leaves hope that it may have considerable effect in promoting financing through assignments in amounts not previously feasible.<sup>38</sup>

#### THE ASSIGNEE AND THE GOVERNMENT

It would hardly be necessary to say that only those complying with the Assignment of Claims Act may claim rights under its provisions, were it not that cases will undoubtedly arise where that particular was overlooked.<sup>39</sup> The initial requisite is that the assignee be a "bank, trust company, or financial institution." The latter term, being the most general, will determine the scope of the Act. In the estimation of the Comptroller General, not every firm that finds it convenient to make occasional loans or credit extensions which are merely incidental to its usual course of business is entitled to be considered a financial institution.<sup>40</sup> The important consideration is whether the firm is primarily engaged in financing, though in a close case a decisive factor may be whether or not the assignment is in accord with the purpose of the Act.<sup>41</sup> Decisions under other statutes interpreting the term "financial institution" will be of little value in this context, since the term is not one of art <sup>42</sup> but one which should be defined in consonance with the statutory purpose. Since any lender can serve that purpose, the term should be liberally construed.

Notice to the designated persons is a second essential requirement before the assignment is valid for all purposes.<sup>43</sup> While there is no authority on the point, failure to notify the surety would probably not be a defect

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37. *Ibid.*

38. See Kupfer, *The Federal Assignment of Claims Act Comes of Age*, 125 N.Y.L.J. 2050, 2072, 2092 (June 4, 5, 6, 1951); Cable, *supra* note 29.

39. Cf. *Hodes v. United States*, 76 F. Supp. 1021 (Ct. Cl. 1948), where the assignment of a claim for preparatory expenditures on a promised contract was held invalid.

40. B-19319, 21 Dec. Comp. Gen. 120 (1941) (an independent insurance agency is not a financial institution); B-27092, 22 Dec. Comp. Gen. 44 (1942) (agents for food packers who occasionally advance money not financial institutions).

41. See B-14415, 20 Dec. Comp. Gen. 415 (1941), in which a partnership engaged in factoring was held a financial institution though not listed in Dun and Bradstreet. The Comptroller here said that the purpose of the assignment was of greater importance than the character of the organization, but this language received some qualifications in B-27092, *supra* note 40.

42. See, e.g., *State v. National Credit Co.*, 236 Ala. 224, 181 So. 769 (1938) (partnership discounting commercial papers a financial institution within meaning of tax statute); *State Tax Comm'n v. Allied Mortgage Co.*, 175 Md. 357, 2 A.2d 399 (1938) (mortgage corporation a financial institution for tax purposes).

43. The 1951 Amendment removed the requirement of notice to the Comptroller General on his suggestion, leaving only notice to the contracting officer, surety, and the disbursing officer, 2 U.S. CODE CONGRESSIONAL AND ADMINISTRATIVE SERVICE 992 (1951).

invalidating the assignment as against the Government, except in an extraordinary case where the rights of the Government were impaired by the oversight. It is probable also that delay in notifying the surety would be unimportant even as to it unless there were evidence that such knowledge would have affected its conduct.<sup>44</sup> Failure to notify the Government would be attended with more serious consequence. As in the case of a private obligor on an assigned contract the Government, in the absence of a no set-off clause, is entitled to reduce the amount owing on the contract by its claims against the assignor until notice of the assignment is received.<sup>45</sup> Upon the receipt of notice of a valid assignment the United States is in the same position as a private debtor. The assignee is therefore entitled to recover on a claim which the Government had erroneously paid the assignor after receipt of notice.<sup>46</sup> Where the assignment is rendered void by the statute the Government may freely set-off its counterclaims against the assigned claim irrespective of when and how the counterclaim arose.<sup>47</sup> In such a case the equities created by the void assignment remain enforceable, however, between the private parties.<sup>48</sup> The importance of notice to perfect an assignment in the event of the contractor's bankruptcy should also be noted in this context. The point will be treated later.

*Recapture.*—The provision of the 1951 Amendment denying recapture of funds paid by the Government on assignments pursuant to the Act was intended to terminate the fears of banks that subsequent investigation of contract payments would subject them to an indeterminate liability after the assignment had apparently been successfully completed.<sup>49</sup> The Renegotiation Act of 1951 had already expressly stated that it did not authorize the withholding or recovery on renegotiation of any moneys due or paid to an assignee under the Assignment of Claims Act.<sup>50</sup> The broader language of the non-recapture clause indicates a desire to confer a wider protection, denying recovery from the assignee of the assignor's tax liabilities as well. In *United States v. Hadden*<sup>51</sup> the question was raised whether

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44. See B-29657, 22 Dec. Comp. Gen. 520 (1942); cf. *Third National Bank v. Detroit Fidelity & Surety Co.*, 65 F.2d 548 (5th Cir. 1933).

45. In a few jurisdictions set-off of a claim maturing after the date of assignment but before notice is not permitted. This rule was rejected in *Campbell v. Equitable Life Insurance Co.*, 130 Fed. 786 (3d Cir. 1904). After notice whether or not there is a no set-off clause, there remains to the obligor the defense that the assignee's right is conditioned upon the assignor's performance, so that in case of default, monies earned on the contract may be applied in completion of the contract or in satisfaction of damages; see *Modern Industrial Bank v. United States*, 101 Ct. Cl. 808 (1944).

46. *Central National Bank of Richmond v. United States*, 91 F. Supp. 738 (Ct. Cl. 1950). Before notice the obligor may pay the assignor without recourse, 4 CORBIN, CONTRACTS, §§ 890, 891 (1951).

47. *United States v. Munsey Trust Company*, 332 U.S. 234 (1947).

48. *McKenzie v. Irving Trust Co.*, 323 U.S. 365 (1945); *Martin v. National Security Co.*, 300 U.S. 588 (1937).

49. See note 36 *supra*.

50. 65 STAT. 7, 50 U.S.C. § 1215 B-5 (Supp. 1952).

51. 192 F.2d 327 (6th Cir. 1951).



that protection would also prevent recapture of money erroneously paid the assignee who, without notice of the Government's mistake, had applied them in reduction of his assignor's debt. The court of appeals decided that while the Government may ordinarily recover funds wrongfully, erroneously, or illegally paid,<sup>52</sup> it was proper on the facts of that case to apply the rule operative between private parties, that restitution may not be had from a bona fide purchaser.<sup>53</sup> The court found the recapture provision indecisive,<sup>54</sup> but felt that the financing of war contracts would be facilitated by the adoption of the principle that the United States engages in commerce on business terms.<sup>55</sup> It is submitted that the decision is sound in the light of the legislative purpose, but it marks the outer limit of the protection given the assignee. Had the assignee reason to know that the payments were erroneous, or even perhaps if they were applied in reduction of a debt not secured by the assigned contract, a contrary result might readily be reached.

*Effect of the Assignor's Fraud.*—A related problem was presented in *Arlington Trust Co. v. United States*,<sup>56</sup> in which the issue was whether the fraud of a contractor in pressing his claim upon the Government precluded his assignee's recovery of the valid part of the claim. A Federal statute provides that a claim against the United States shall be forfeited "by any person" who fraudulently attempts to establish it.<sup>57</sup> The corresponding section of the predecessor of this statute<sup>58</sup> had been interpreted to mean that the contractor's fraud would bar recovery of a surety's claims by subrogation arising from the contract,<sup>59</sup> as it would the claims of the contractor's receiver in bankruptcy.<sup>60</sup> The Government in the instant case contended that the trust company must also be bound since its rights likewise derived from the contractor whose claim was forfeited. The Court of Claims gave judgment for the trust company holding that while the language of its previous decisions may have been unnecessarily broad, in any event the Assignment of Claims Act had the effect of tempering the strict rule of forfeiture in favor of finance companies who were thereby encouraged to lend to Government contractors. This decision is not a neces-

52. See, e.g., *United States v. Wurts*, 303 U.S. 414 (1938); *Wisconsin Central R.R. v. United States*, 164 U.S. 190 (1896); *Whiteside v. United States*, 93 U.S. 247 (1876).

53. RESTATEMENT, RESTITUTION §§ 13, 14 (1937). The assignee-creditor whose debt is repaid is treated as a special instance of the bona fide purchaser rule.

54. The analogy of the CONTRACT SETTLEMENT ACT, 58 STAT. 649 (1944), 41 U.S.C. § 101 (1946), in which the prevention of improper payments was expressly subordinated to the encouragement of adequate financing, was persuasive as to the priority to be observed here.

55. Cf. *United States v. National Exchange Bank of Baltimore*, 270 U.S. 527 (1926); *United States v. Seaboard Air Line Ry.*, 22 F.2d 113 (4th Cir. 1927).

56. 100 F. Supp. 817 (Ct. Cl. 1951).

57. 62 STAT. 978 (1948), 28 U.S.C. § 2514 (Supp. 1952).

58. 28 U.S.C. § 279 (1946).

59. *Globe Indemnity Co. v. United States*, 84 Ct. Cl. 587 (1937), *cert. denied*, 302 U.S. 707 (1937).

60. *Jerman v. United States*, 96 Ct. Cl. 540 (1942). *But cf. Baird v. United States*, 76 Ct. Cl. 599 (1933).

sary result of the 1940 Assignment of Claims Act. While a conforming assignment is valid "for all purposes," here, if the claim in its entirety is void, nothing is assigned, however valid the assignment may be. There are no obvious equitable grounds for distinguishing the assignee from the trustee in bankruptcy or the surety in relation to the contractor's fraud. In fact, in other situations involving the same parties, the surety and the trustee in bankruptcy stood better than the bank.<sup>61</sup> Therefore, the *Arlington Trust* case considerably modifies prior law. To speak of congressional intent in these circumstances is more than usually fictional since there is no indication that this problem was even alluded to in the course of legislative consideration of the 1940 Act.<sup>62</sup> The question is whether the impairment of the deterrent purposes of the forfeiture statute is outweighed by an advancement of the purposes of the Assignment Act. The fraudulent contractor may gain by this decision to the extent that his debt to the bank is paid by the claim allowed, but there is a strong basis for subrogating the Government to the bank's rights against the contractor<sup>63</sup> either on the loan or on the contractor's implied warranty not to impair the value of his assignment. The cost and risk of recovery is thereby transferred from the bank to the Government, but this is hardly unreasonable where the Government seeks only a windfall while the bank looks for repayment. The complete destruction of the bank's collateral for the contractor's fraud has such a possible deterrent effect on financing that there is strong reason for the confinement of so clumsy a sanction. Some confirmation of the Court of Claims decision is found in the 1951 Amendment which, in contracts containing the no set-off clause, forbids reduction of the assigned payments by reason of liability of the assignor arising from fines or penalties.<sup>64</sup> The penalty of forfeiture is presumably included. As to contracts not containing that clause, the rule of the *Arlington Trust* case remains the only authority.

*Penalty Provisions.*—Limitations on the Government's right of recapture and set-off permits the assignee in the instances discussed to have a stronger position than his assignor. In all other aspects the rights of the assignee depend on the terms of his assignor's contract and are contingent upon the assignor's performance. In this respect it should be noted that certain provisions of the Davis-Bacon Act<sup>65</sup> require the insertion in

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61. Cf. *Prairie State Bank v. United States*, 164 U.S. 227 (1896); *Goodman v. Niblack*, 102 U.S. 556 (1880). A possible if arid distinction suggested by the *Jerman* case, *supra* note 60, is that the assignee is a purchaser for value.

62. In determining the applicability of a statute to a new situation the court's duty is to construe it as their judgment instructs them the lawmakers would have done had they acted with the present situation in mind. Cf. *Vermilya-Brown Co. v. Connell*, 335 U.S. 377, 388 (1948).

63. See 65 HARV. L. REV. 1448 (1952). The court expressly left open this question. Another situation in which the contractor might gain by virtue of having assigned the contract arises where the no recapture clause protects the assignee in excess of his interest in the assignment. See the criticism of the Comptroller General, 2 U.S. CODE CONGRESSIONAL & ADMINISTRATIVE SERVICE 1414 (1951).

64. See note 37 *supra*.

65. 46 STAT. 1494 (1931), as amended, 40 U.S.C. § 276-a (1946). This applies to every contract in excess of \$2000 for the construction, alteration, or repair of public buildings in continental United States to which the government is a party.

some Government contracts of a clause authorizing the withholding from accrued payments of as much as is necessary to compensate for the contractor's failure to pay designated minimum wages. The Comptroller General may pay these withheld payments directly to the underpaid laborers. Similarly the Eight-Hour Law<sup>66</sup> requires that Government contracts include a penalty provision and directs the withholding of the penalty from moneys otherwise due on the contract. Finally, the Walsh-Healey Act<sup>67</sup> imposes certain labor regulations on the performance of Government contracts for the manufacture or furnishing of materials and requires the addition of a liquidated damage provision for failure to observe these regulations. The 1951 Amendment to the Assignment of Claims Act would prevent recovery from the assignee of moneys paid on the contract. Ordinarily the no set-off clause will also protect the assignee against fines and penalties arising from the job which are assessed against his contractor, but an exception is made in case of penalty provisions incorporated in the contract. The legislative history makes clear that this exception was intended to include the penalties of the wage and hour laws. Amounts so withheld could readily reach substantial proportions. The scope and terms of these labor requirements are subject in many instances to modifications or suspension in an emergency. An analysis of the current situation is outside the orbit of this Note; but financial organizations will be well advised to consider a possible assignor's ability to perform in relation to this risk, from which the 1951 Amendment does not protect them.

Other contract provisions may be of even more controlling importance in respect to the feasibility of financing. Initially, care must be taken that the complete contract is known, for occasionally important conditions are incorporated by reference to the terms of the offering for bids. Where there are advance payment arrangements, in effect a Government loan to start the contractor, there is also a statutory lien granted the Government<sup>68</sup> which has been found to make financing with an assignment as collateral inadvisable. Progress payment terms where payment is made before delivery (as opposed to partial payment for units as delivered) may raise additional difficulties.<sup>69</sup> Generalizations are of little assistance here because the impact of these and other arrangements varies with the facts of each

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66. 37 STAT. 137 (1912), 40 U.S.C. § 324 (1946), as amended, 62 STAT. 989 (1948), 40 U.S.C. § 324 (Supp. 1952). This applies to all contracts to which the United States is a party. The penalty is \$5 for each man-day longer than eight hours. This provision was suspended during the war.

67. 49 STAT. 2036, 2037 (1936), as amended, 56 STAT. 277 (1942), 41 U.S.C. §§ 35, 36 (1946). This applies to all such contracts aggregating more than \$10,000 in total payments. The assessed penalties are \$10 per day for each convict, boy under sixteen, or woman under eighteen employed, plus a refund of unpaid wages and an option to the government to cancel the contract in event of breach. The Secretary of Labor may make exemptions under 49 STAT. 2038, 41 U.S.C. § 38 (1946).

68. 62 STAT. 24 (1948), 41 U.S.C. § 156 (Supp. 1952); 63 STAT. 396 (1949), 41 U.S.C. § 255 (Supp. 1952).

69. See Denonn, *Financing Government Contracts*, N.Y. STATE B. BULL. 443, 445 (Dec. 1951).

case, but since the assignee's rights are only derivative, failure to study the terms of his assignor's contract may lead to serious embarrassment.

### THE ASSIGNEE V. THE SURETY

By the Miller Act,<sup>70</sup> each contractor is required to furnish a payment and construction bond before he may be awarded any contract involving more than \$2,000 for the construction or repair of any public building or public work.<sup>71</sup> The relative rights of a surety on such a contract and the bank holding an assignment of the contract remain a major unsettled question. Before the Assignment of Claims Act it was settled that a surety performing the contract upon the contractor's default was accordingly subrogated to the rights and remedies which the United States could have exercised against the defaulting contractor. For example, if the contract provided for retention of a percentage of the earned payments to secure complete performance, the Government, upon the contractor's breach, would be entitled to use that fund to complete the contract; consequently, the surety who completed the contract would obtain that fund.<sup>72</sup> An assignee-bank for this purpose is considered to have no greater standing than its assignor because its rights are conditioned upon the assignor's performance. Since that is the risk borne by the bank in the absence of a surety, and because the bank did not bargain for the surety, when present, to assume the risk, courts have generally not regarded it as material whether or not the retained payments are attributable to the bank's money expended on the contract in question.<sup>73</sup> The surety has also prevailed where by its bond it was compelled to pay laborers and material men remaining unpaid after the contractor had completed the job.<sup>74</sup>

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70. 49 STAT. 793, 794 (1935), 40 U.S.C. § 270a-d (1946). The act for a time was suspended, but has again been reinstated.

71. At first glance it may seem that the surety requirement is a needless expense, for the United States is certainly capable of self-insuring, but this overlooks the great contribution of the surety in investigating and supervising contractors which, by protecting the surety's own interest, insures protection of the Government's, and obviates possible political abuses that might arise if the Government had to pass on the financial position of the low-bidding contractor.

72. *Prairie State Bank v. United States*, 164 U.S. 227 (1896). The usual surety bond also contains a present assignment to the surety of the contractor's rights in the contract effective on his default. In these early cases this assignment as well as the bank's was void as against the Government, and the cases rest on right by subrogation rather than priority of assignment. The bank will be held to have constructive notice of some surety's equity on the contract because of the statute requiring a surety. Consequently the surety will usually have also the prior assignment, if the assignment is held to be effective from the date of the bond.

73. 4 CORBIN, CONTRACTS § 901 (1951). The argument that the assignee's money expended on the contract pro tanto reduces the surety's prospective liability is defective in failing to view the contractor as an economic unit. Other creditors satisfied free funds to pay those on the present contract. In any event of course, the surety is entitled only to recompense, see, *e.g.*, *Lacy v. Maryland Casualty Co.*, 32 F.2d 48 (4th Cir. 1929).

74. *Hardaway v. National Surety Co.*, 211 U.S. 552 (1909); *Henningsen v. U.S. Fidelity & Guaranty Co.*, 208 U.S. 404 (1907). The doctrine here is more difficult to parse since the Government is relieved of no legal obligation to pay the material men; *cf.* *United States v. Munsey Trust Co.*, 332 U.S. 234 (1947); *Schmoll*

The Assignment of Claims Act of 1940 had the effect of rendering the assignment to the bank directly assertable against the United States, though the surety's was not.<sup>75</sup> That in itself would not have been expected to alter the respective positions of the assignee and the surety since the surety had generally predominated before, even where, as under state law, the bank's assignment was valid.<sup>76</sup> Nothing in the legislative history indicates any conscious intent to change this relationship.<sup>77</sup> The Court of Appeals for the Fifth Circuit, however, in *Coconut Grove Exchange Bank v. New Amsterdam*,<sup>78</sup> relying upon the language that the assignment was valid "for all purposes" and upon the requirement of notice to the surety, found that the 1940 Amendment had materially altered the former situation. Accordingly the bank, since its assignment alone was valid, prevailed over the surety as to a payment earned but unpaid at the time of the contractor's default. The surety's claim of priority by subrogation was also denied since it had not met the burden peculiar to that circuit<sup>79</sup> of showing that the bank's money had been diverted from the job. A later case in the same circuit makes a distinction as to unpaid progress payments and percentages retained, giving the bank the former and the surety the latter.<sup>80</sup> This splits the pie nicely, but the logic of the distinction is tenuous. The percentages retained to insure performance may well be given to the completing surety, but the Government has as much right to use the progress payments due the defaulted contractor to finish the contract as it does the percentages, and the surety performing the contract would seem to be subrogated equally to the Government's rights in both funds. There is, however, a less traditional argument, not advanced by the court, which tends to

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v. United States, 63 F. Supp. 753 (Ct. Cl.), *cert. denied*, 310 U.S. 724 (1946); compare *Belknap Hardware & Mfg. Co. v. Ohio River Co.*, 271 Fed. 144 (6th Cir. 1921) which finds in the bond requirement congressional intent that laborers and material men have an "equitable priority." Where statute requires government contracts to stipulate the government's right to withhold payment until these men are paid, the interest to which the surety is subrogated is more apparent. 46 STAT. 1494 (1931), as amended, 40 U.S.C. § 276 (1946).

75. See note 4 *supra*.

76. 4 CORBIN, CONTRACTS § 901 (1951); see, e.g., *Standard Accident Insurance Co. v. Federal National Bank*, 112 F.2d 692 (10th Cir. 1940).

77. See Nichols, *Assignment of Claims Act of 1940*, 12 U. OF PITT. L. REV. 538 (1951).

78. 149 F.2d 73 (5th Cir. 1945). The payment in question was part of the retained percentages.

79. See *Town of River Junction v. Maryland Casualty Co.*, 133 F.2d 57 (5th Cir. 1943), criticized in 56 HARV. L. REV. 1168 (1943). The assignee is entitled to payment as long as his assignor would be, cf. *Town of River Junction v. Maryland Casualty Co.*, 110 F.2d 278 (5th Cir. 1940) (first appeal), or if a purchaser without notice of the surety's assignment may hold monies received from the contractor, cf. *California Bank v. United States Fidelity and Guaranty Co.*, 129 F.2d 751 (9th Cir. 1942); so also if the bank has received an assignment from the laborers of their claims, it will be preferred over the surety obligated to satisfy those claims, as to balances due from the obligor. See *Third National Bank v. Detroit Fidelity and Surety Co.*, 65 F.2d 548 (5th Cir. 1933), *cert. denied*, 290 U.S. 667 (1933); but this is clearly distinguishable from loaning money to the contractor who merely uses it on the contract.

80. *General Casualty Company of America v. Second National Bank of Houston*, 178 F.2d 679 (5th Cir. 1949).

support its distinction between progress payments and retained percentages. The labyrinthine workings of government frequently lead to long delays in making progress payments. The Act protects the bank as to funds actually received by it. It can be argued therefore that the position of the bank should not be made to depend on accidents of speed or slowness of payment, but that delayed payments should be treated as received.

The Court of Claims, the only other court to pass on the effect of the Assignment of Claims Act in this area, has rejected the Fifth Circuit view. In *Royal Indemnity Co. v. United States*,<sup>81</sup> it held that while the bank's assignment is the only one valid against the United States, the bank taking with actual or constructive notice of the surety takes subject to that equity. The surety's claim is superior to the defaulting contractor's and so to the assignee's derivative rights. Support for this view is found in the 1951 Amendment which was intended to exclude the assignee from all risks except those arising directly from the assignor's failure to perform. The contractor upon default sacrifices his rights in so much of the money owed him on the contract as is necessary to make the Government whole. The Court of Claims feels that whether the surety or the Government uses these funds in completing the contract should not alter the risk initially assumed by the assignee.

The thesis fundamental to this Court of Claims' view is that the assignee stands no better than his assignor.<sup>82</sup> As we have seen this is not always the case, and, to the extent that it is not, certain anomalies arise which lend collateral support to the Fifth Circuit's view. For example, whether or not the earlier decisions of the Comptroller General were correct, the 1951 Amendment makes clear that where the contract contains a no set-off clause, tax claims against the assignor arising either from or independently of the contract assigned may not be used to reduce amounts otherwise due and payable to the assignee.<sup>83</sup> In *United States v. Munsey Trust*,<sup>84</sup> the Supreme Court held that the Government, notwithstanding the claims for reimbursement of a performing surety, was entitled to set off its claims arising from an independent contract against the retained percentages of the contract completed by the surety. This leaves then a situation where the Government may make a set-off against the surety which it cannot make against the bank, though in the Court of Claims the surety's

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81. 93 F. Supp. 891 (Ct. Cl. 1950); *accord*, *Hardin County Savings Bank v. United States*, 65 F. Supp. 1017 (Ct. Cl. 1946); *cf. In re Cummins Const. Corp.*, 81 F. Supp. 193 (D. Md. 1948). The dissenting judge in the *Royal Indemnity* case expressed a fear that the majority's decision would frustrate the purpose of the assignment act.

82. *Cf. Modern Industrial Bank v. United States*, 101 Ct. Cl. 808 (1944).

83. See note 36 *supra*; the contractor has of course no such protection, see *Cherry Cotton Mills Inc. v. United States*, 327 U.S. 536 (1946).

84. 332 U.S. 234 (1947). *Contra: Maryland Casualty Co. v. United States*, 513 F. Supp. 436 (Ct. Cl. 1944). *Cf. Standard Accident Ins. Co. v. United States*, 97 F. Supp. 829 (Ct. Cl. 1951) (tax set-off permitted). *But cf.*, Comp. Gen. Dec. B-100314 (Sep. 24, 1951) government may lose the right to set-off by virtue of a completion agreement with the surety.

right to the fund endangered by the asserted set-off, is held to be greater than the bank's. Where all three claims are present it may be that the surety will prevail to the extent that it is subrogated to the bank's protected interest. The Fifth Circuit view has at least the advantage of removing this circularity. No such case as the hypothetical has arisen, but a Supreme Court decision on those facts would do much to settle the law in this area.

In conflict between the surety and the assignee no resolution of the policy considerations is readily discernable. Both the surety and the bank have voluntarily assumed a risk for compensation. Should the bank prevail over the surety as to retained percentages and unpaid progress payments, that fact would tend to improve the security offered by the assignment and to some extent facilitate bank financing. It may be doubted, however, whether the increase will be appreciable. Under the 1951 Amendment the assignee is assured payment if his assignor performs. In deciding whether or not to make a loan with the assignment as collateral, the major consideration is whether the contractor has the technical ability to do the job with modest profit, or at least without loss. The concern as to what may be salvaged should default occur is of secondary importance since the loan will only be made where default appears unlikely. The bank will always know from the contract if there is a surety, and can bear in mind the impact of that opposed interest in the contingency of default. The surety, on the other hand, before accepting its risk frequently does not know if the contract will be assigned. Should assignment occur with sufficient regularity, the rate can be adjusted to off-set the average cost to the surety of the assignee's rights in case of default. It is possible, however, that the probability of assignment and its effect on the number of bonds issued by each surety may not be sufficiently predictable to enable so simple an adjustment. Should this be the case there is much to be said in favor of retaining the earlier judge-made rule which prefers the performing surety to the assignee.

#### PROBLEMS FROM THE ASSIGNOR'S BANKRUPTCY

Bankruptcy is the arena in which the adequacy of a security arrangement is most severely tested. So far as assignments of accounts receivable are concerned, the conflict there is part of an ancient controversy between the lender's interest in achieving simple, effective security devices and a general commercial interest in the avoidance of secret liens. The principal contestants from which the assignee must take care to protect his security interest are subsequent assignees of all or part of the same account and general creditors of the assignor. In the bankruptcy act it is the power of the trustee to set aside preferential transfers perfected within four months of bankruptcy, which particularly brings to focus both these issues.<sup>85</sup> Under the 1938 act a transfer was defined as perfected when a bona fide purchaser from the debtor could not defeat the transferee's rights

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85. 30 STAT. 562 (1898), as amended, 11 U.S.C. § 96b (1946).

under state law to the property in question.<sup>86</sup> In *Corn Exchange Bank v. Klauder*,<sup>87</sup> this was interpreted to mean that, in states adhering to the English rule,<sup>88</sup> an assignment was not perfected until the assignee had notified the obligor. A subsequent lower court decision interpreting the Massachusetts rule<sup>89</sup> presented the disturbing possibility that a non-notifying assignee would lose his security in all but eleven states in the event of the assignor's bankruptcy.<sup>90</sup> These discussions precipitated such a rash of book marking, notice filing and validation statutes designed to safeguard the assignment of accounts receivable<sup>91</sup> that the 1950 bankruptcy amendment,<sup>92</sup> substituting a lien creditor test for the bona fide purchaser test, has been of negligible effect.<sup>93</sup> While the generative reason is now past, this statutory legacy of recent bankruptcy history remains in most states of controlling importance, supplementing or replacing the three case-law rules by which the assignee's rights were governed.

The Assignment of Claims Act provides that any assignment pursuant to its terms shall be valid for all purposes. Upon the Government's receipt of the requisite notice, the transfer would be complete as to the Government. The question arises, however, whether the transfer would also be perfected as to a lien creditor in a state requiring recording for validity against such a creditor. There is no authority squarely on point here. The validity of a transfer in bankruptcy is a federal question, though ordinarily determined by reference to the law of the state where the transactions in question occurred. Here it would seem that the Assignment of Claims Act is a controlling federal statute, and that the rights acquired by the assignee under it would enable him to prevail irrespective of state law.<sup>94</sup> Where

86. 52 STAT. 869 (1938), 11 U.S.C. § 96a (1946). For a history of the problem, see McLoughlin, *Defining a Preference in Bankruptcy*, 60 HARV. L. REV. 233 (1946). The effect of the amendment on the assignment of accounts receivable was not studied in advance, *id.* at 245.

87. 318 U.S. 434 (1943).

88. As to which of two bona fide assignees prevails three rules are in common use. The English rule gives judgment to the first to notify the obligor, see *e.g.*, *In re Phillips Estate*, 205 Pa. 515, 521, 55 Atl. 213, 216 (1903); the American rule, to the first assignment, see *e.g.*, *Moorestown Trust Co. v. Buzby*, 109 N.J. Eq. 409, 157 Atl. 663 (1931); and the Massachusetts rule to the first assignment with four exceptions, see RESTATEMENT, CONTRACTS § 173 (1932).

89. *In re Vardamen* 52 F. Supp. 562 (E.D. Mo. 1943). *Contra: In re Rosen*, 57 F.2d 997 (3d Cir. 1946), *cert. denied sub nom. Fisch v. Standard Factors Corp.*, 330 U.S. 835 (1947). The Third Circuit held that a subsequent purchase prevailing by virtue of one of the four equitable exceptions to the Massachusetts rule did not prevail qua purchaser.

90. See Conwill and Ellis, *Much Ado About Nothing*, 64 HARV. L. REV. 62, 68 (1950).

91. See Pemberton, *Notice Filing for Assignments of Accounts Receivable*, 13 LAW & CONTEMP. PROB. 643 (1948); Koessler, *Assignment of Accounts Receivable*, 33 CALIF. L. REV. 40, 59 (1945).

92. 64 STAT. 25 (1950), 11 U.S.C. § 96a (Supp. 1952).

93. See Conwill and Ellis, *supra* note 90, at 78. Unlike a bona fide purchaser a lien creditor can not ordinarily defeat the equitable interest of a prior non-notifying assignee; see 2 WILLISTON, CONTRACTS § 434 (Rev. ed. 1936).

94. *Cf. McKenzie v. Irving Trust Co.*, 323 U.S. 365 (1944). Here the assignee of a federal contract did not notify the Government until within the four month period. The Supreme Court expressed no opinion as to the effect of such notice since the property in question had been transferred by the endorsement and mailing of a check more than four months before bankruptcy.



the assignee has not complied with the Assignment of Claims Act, the assignment is void as to the government but the equities between the private parties will be enforced.<sup>95</sup> State law will here determine the sufficiency of the transfer, for the assignee can derive no benefit from the federal statute. In Pennsylvania, for example, it is probable that the lien creditor would prevail against an assignee who had neither notified his assignor nor complied with the book-marking statute.<sup>97</sup> Where the assignment was made more than four months prior to bankruptcy but notice was not given to the Government until within the four month period, that transfer must be considered as made when notice was given. In such a case the assignee is only protected if the assignment without notice to the obligor was already, under state law, valid against a lien creditor before the four month period.<sup>98</sup>

So far as an assigned contract remains executory, it is ordinarily of little value as security in event of the assignor's bankruptcy. It is possible, however, that it may survive unaffected. Bankruptcy vests the trustee in bankruptcy with all the property of the bankrupt including rights of action on a contract.<sup>99</sup> The trustee has no obligation to complete executory contracts. He may accept or reject them,<sup>100</sup> but should he accept and perform a contract he takes it *cum onere*, and the holder of a valid assignment is entitled to the benefits of his assignment.<sup>101</sup> Ordinarily the bank-assignee may retain of the proceeds of the contract only so much as is necessary to repay the loan secured by the assignment.<sup>102</sup>

#### THE ASSIGNMENT AS COLLATERAL

The assignment of claims to become due on a presently executory contract is an unusual security device since its worth is entirely dependent on the contractor's ability to perform his contract. As a practical matter,

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95. See note 14 *supra*. But see *In re Meadow Sweet Farms*, *supra* note 14.

96. *McKenzie v. Irving Trust Co.*, 323 U.S. 365 (1944); *In re Rosen*, 57 F.2d 997 (3d Cir. 1946).

97. PA. STAT. ANN. tit. 69 §§ 561, 562 (Purdon Supp. 1951). The converse is an arguable proposition. Prior to this statute the non-notifying assignee was superior to a lien creditor. *Bartram B. & L. Ass'n. v. Eggleston*, 335 Pa. 42, 6 A.2d 508 (1939). The book marking statute changes that only by implication.

98. *McKenzie v. Irving Trust Co.*, 323 U.S. 365 (1944).

99. 30 STAT. 565 (1898), as amended, 64 STAT. 26, 11 U.S.C. § 110a, b (1946).

100. 64 STAT. 26, 11 U.S.C., §§ 110-113 (1946).

101. See, *In re Italian Cook Oil Corp.*, 190 F.2d 994 (3d Cir. 1951). There is language in the opinion that state law determines the effectiveness of the assignment. Generally that is certainly the case, but on the facts of the case this seems to overlook the controlling federal statutes.

102. Cf. *Joseph F. Hughes Co. v. Machen*, 164 F.2d 983 (4th Cir. 1947), *cert. denied*, 333 U.S. 881 (1948), where it was held that if the assignor has a bona fide deposit made in due course of business in the assignee-bank, the bank with knowledge of the assignor's insolvency and within the preferential period may set-off assignee's deposit against his debt to bank even where the deposit is attributable to funds paid on an assignment of a government contract as security for loans already repaid.

the risk assumed depends primarily on the assignor's financial condition at the start of his contract, his ability to handle the job, and the profit possibilities of the contract. These matters are of accentuated importance where, as is now so frequently the case with government procurement contracts, the contractor has had little or no experience producing the article in question. There, even if he has the technical know-how, he may have miscalculated the cost of unfamiliar work. With lump-sum contracts currently in vogue, a serious miscalculation can readily cause default.<sup>103</sup>

The usual assignment of accounts receivable differs from these assigned contracts in several respects. Since assignments of book accounts arising in the future are not generally enforceable,<sup>104</sup> the debts assigned in accounts receivable are either due or to become due on a day certain. The major risk then, positing that the account is genuine, is the obligor's credit. Since generally a variety of accounts are assigned the risk is spread and with a margin for bad debts the return is relatively sure. In the assignment of Government contracts, the obligor's credit is the least of the assignee's worries. His main concern is that, since the loan to be of use must ordinarily be for most of the face value of the contract, the risk is necessarily highly concentrated and secured by collateral of no value except so far as the assignor performs. In consequence, additional collateral is frequently desirable. Because total default on the contract is unlikely where the contractor has been adequately investigated, a relatively small amount of additional tangible collateral assumes increased importance when the later, more critical stages of the contract are reached. An alternative safeguard frequently found accompanying an assigned defense contract is a loan guarantee under the Defense Production Act.<sup>105</sup> Customarily, the Government department most interested in the contract guarantees from fifty to ninety percent of the loan. Losses and payments are ratably applied in proportion to the guaranteed and unguaranteed percentages. A maximum of five percent interest is permitted on a guaranteed loan from which are deducted guarantee fees, increasing as the proportion guaranteed increases. As of December 1951, loan guarantees exceeding one billion dollars had been authorized.<sup>106</sup> The guarantees make possible financing that might otherwise be exceedingly risky; but there are delays in obtaining them, they are of limited availability, and are accompanied by restrictions. They supplement rather than supplant the assignment of contracts as collateral.

Ten years of experience with the assignment of Government contracts has demonstrated the utility of the security device. Aside from its sig-

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103. Royall, *Forms of Military Contracting*, 37 A.B.A.J. 97 (1951); the safer cost plus percentage of cost contracts are now prohibited, and the use of a cost plus a fixed fee contract restricted, 62 STAT. 23 (1948), 63 STAT. 395 (1949), 41 U.S.C. §§ 153, 254 (Supp. 1952).

104. 2 WILLISTON, *CONTRACTS* § 413 (Rev. ed. 1936).

105. 64 STAT. 800, (1950), 50 U.S.C. App. § 2091 (Supp. 1952); see Emerson, *Federal Guarantee of Business Loans*, 64 HARV. L. REV. 615 (1951).

106. FED. RESERVE BULL. (December 1951).